

Brock Dairy Market Intelligence

October 16, 2009

Market Update:

Dairy producers were just starting to breath a little easier with Class III prices roughly \$2.00 or more above their recent lows until late this week. On Thursday, Class III turned lower on a weaker cheese trade that rolled into a more aggressive sell-off on Friday with the front three months down \$0.20—\$0.30 cents. On the back page, a reference is made regarding block cheese hitting a wall at \$1.50. Having said this, it is possible that just enough holiday demand has been priced into cheese to give the edge back to the sellers. While it is doubtful that all the holiday demand for cheese is priced, we all know how price sensitive this market is and without cheese buying, cheese and Class III futures turned down.

Additional price weakness may be ahead as the market transitions back to the old (lower) price supports on November 1. While the issue of price supports and their degree of influence on a market can cause fist-fights among economists, dairy producers and nearly everyone else. We do not believe the market has to re-challenge the support levels given that milk production & cheese stocks are tightening up along with more cows going to slaughter from CWT. Milk production will soon be at the three-year average and cheese stocks have hit their seasonal peak; see charts. Next weeks September Milk Production report should provide just enough encouragement that cheese buyers will have to pony-up in a tightening milk market and make a purchase. However, it may take blocks back to \$1.35.

Even for the now highly leveraged dairy producer, Class III just has not offered a favorably price to offset some risk for the past several months. Every dairy is different and everyone must have a perspective of their risk tolerance and must identify that there is good and bad risk.

In developing a marketing plan, producers need to know their risk tolerance or risk bearing abilities. Everyone's balance sheet is different even though many have become

more alike (added debt; less equity) over the last 12 months. At this point, marketing decisions for the next several months is really an individual decision. There just is not an easy answer to managing risk. As we all know, the market does not care what your breakeven is or what a producers cost of production is. European dairymen are going through the same challenges of selling milk below the cost of production.

While we only care about our own bottom-line, let's provide some guidance for a dairy with three different debt ratio's and what a short term marketing plan should look like.

Dairy # 1 — Highly leverage, 10% equity:

Based on cost of production, locking in 20% of Class III through June of 2010 that offer a 2% return should be considered. Another 20% should be priced at 3% and 30% at 3.5%.

Dairy # 2 — Debt ratio; 6:1:

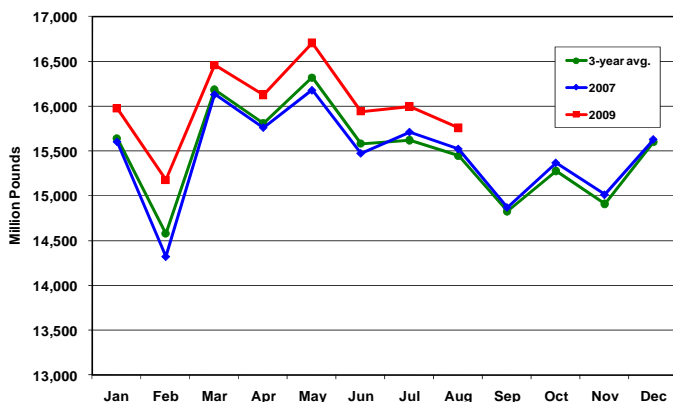
This dairy has a little wiggle room but not much vs. the above. The first two sales should be followed but the third sale can be adjusted higher to a 4.5% return to the operation.

Dairy # 3 — Debt ratio; less than 4:1:

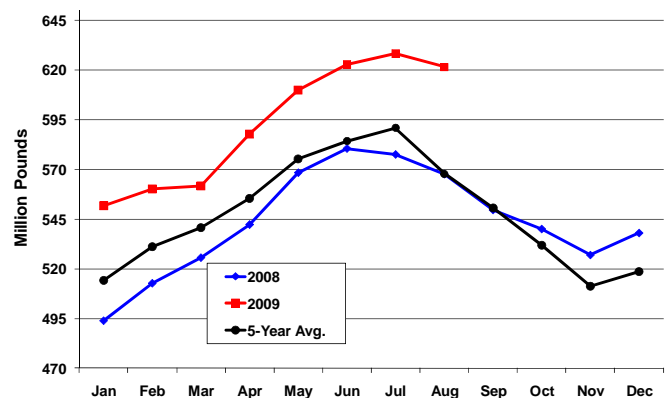
While this dairy may have more equity to risk, it may be coming from zero debt. Regardless, a plan for the moment would be to start at a 3% return on 30% and do another 30% at 4%. Chances are, that is about as far as a dairy producer in this category will go unless other risks exists such as feed or management.

The bottom-line here is that very few dairies if any will recover lost equity in the next 12 months that has been lost in the last 12. Everyone should spend time reviewing their costs and operation and consider where you relate to the above. For the second half of 2010, a Plan B will be developed in another issue since we believe the fundamentals will improve. However, milk production may need to get to a 4% reduction year over year to really sustain favorable Class III prices.

US Milk Production



US American Cheese Stocks



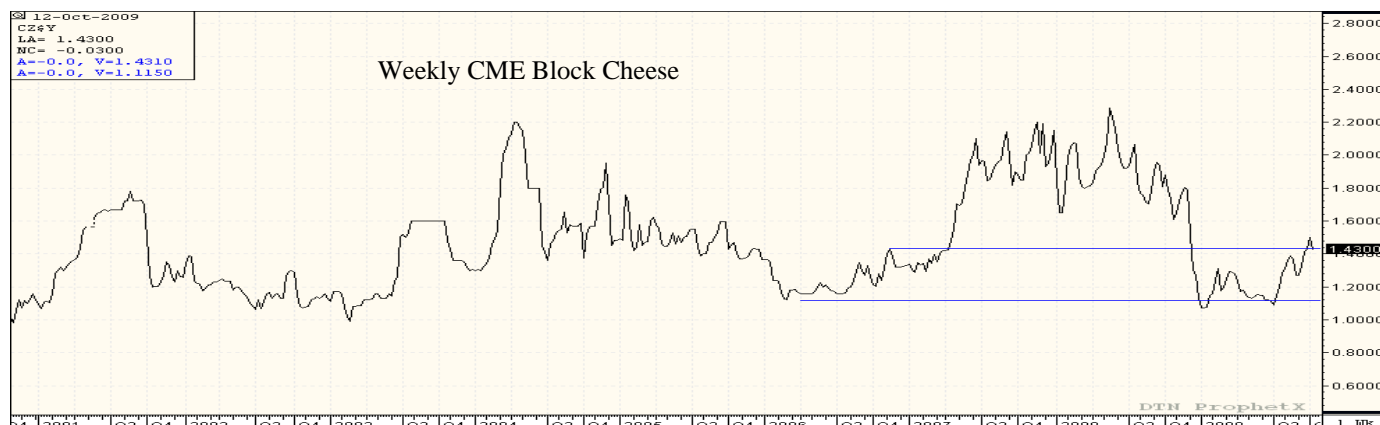
Cash Cheese

Block cheese may have hit a wall at roughly \$1.50 as the aggressive cheese buyer likely has an inventory of holiday demand priced. As suggested in the last issue, having some risk protection in the January Class III \$13.50 or \$13.75 put option is necessary if the order has not been passed on to a customer. The economy still drags-on and that keeps pizza chains and most other cheese users from wanting to clock their cheese inventory going forward.

Even though USDA has money to buy surplus commodities and distribute them, it is now likely a non-factor for the market as milk supplies tighten. USDA must be trying to leverage their allotted funds from Congress to give away these commodities & get some publicity around the holidays which is fine but the process appears slow at best.

Other dairy product prices keep climbing to support the laws of economics regarding tighter milk supplies nationwide. The next market event will be this weeks Milk Production report that should show additional tightness in milk supplies. To summarize, whey, butter & nonfat markets should continue their positive price trend but cheese will continue to see-saw between \$1.35—\$1.50.

There is risk of losses as well as profits when trading futures and options.



Current Market Prices			
Commodity	This Week	2 Weeks Ago	Change
Supreme S. Cen. KS Alfalfa (ton)	\$130.00	\$130.00	unch
Tulare-Visalia Supreme Ca. Alfalfa	\$165.00	\$160.00	\$5.00
Whole cottonseed (ton, Memphis)	\$195.00	\$192.00	\$3.00
Corn Gluten Meal (60 percent, ton, IL)	\$597.50	\$517.50	\$80.00
Distillers Dried Grain (ton, Centr. IL)	\$122.00	\$105.00	\$17.00
Soybean Meal (48%) Illinois (Tues.)	\$337.80	\$335.50	\$2.30

Source: United States Department of Agriculture

Current Dairy Market Prices			
Commodity	This Week	2 Weeks Ago	Change
CME Block Cheese (avg. to Wed.)	\$1.5067	\$1.4125	\$0.0942
CME Barrel Cheese (avg. to Wed.)	\$1.4575	\$1.372	\$0.0855
CME Butter (avg. to Wed.)	\$1.2425	\$1.248	-\$0.005
Nearby Class III Futures (Wed.)	\$12.753	\$12.08	\$0.67
Dry Whey- FOB Central	\$0.3275	\$0.315	\$0.0125
Non-Fat Dry Milk—California Manufacturing Plants	\$0.9817	\$0.9575	\$0.024

USDA-ERSFORECASTS			
	IV-2009	I-2010	II-2010
Commercial Use (billion lbs.)	48	44.4	46.8
Class III Price (average)	\$11.75	\$12.82	\$13.67

Current Milk Market Positions
Milk Coverage...
Long October Class III @ \$12.35 for 100% of October's milk production as a hedge against a potential negative PPD.

On The Feed-Purchasing Side
Corn:
Cash coverage through October.
Soybean Meal:
Same as above for corn.
Cottonseed: Buy hand-to-mouth
Most dairies have stopped using cottonseed but prices are getting close to being somewhat attractive.